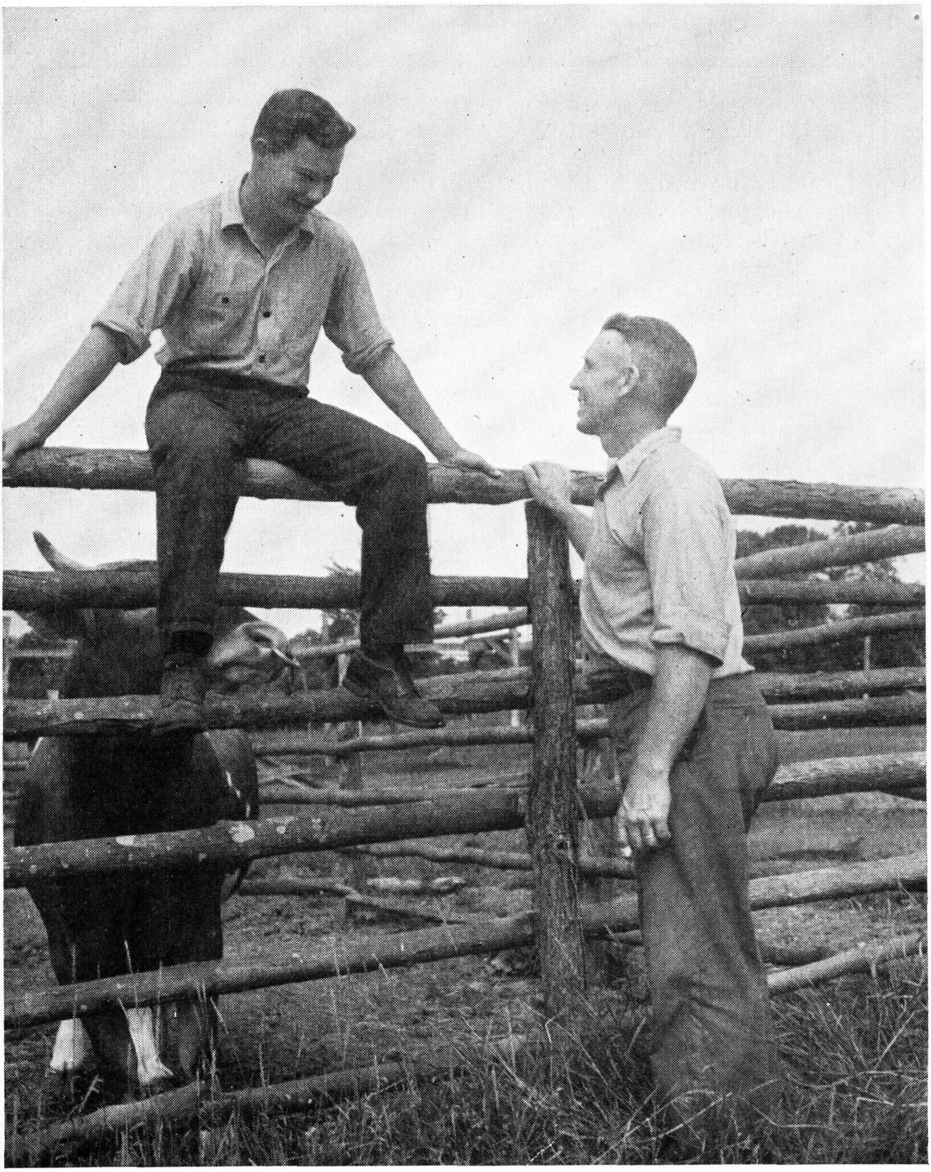
FATHER-SON FARM OPERATING AGREEMENTS



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THE large amount of capital needed to establish a successful farm business creates a big problem for young men who want to become farmers. How can they obtain the capital to get started in farming? What arrangements can be made for father-son operation of the home farm?

Parents of farm boys have problems too. How can they keep up the productivity of their farms during the years when their strength is not what it used to be? Isn't there some way they can help establish their sons by transferring the responsibility for the farming to them, and still insure their own future security?

This bulletin considers these and other questions. It provides general information for fathers and sons who want to operate farms together for their mutual benefit. The facts upon which it is based came from many sources—from farmers in 20 States through personal interviews with them on their farms; from such agricultural leaders as county agricultural agents, vocational agriculture teachers, supervisors of veterans' institutional on-farm training, bankers, lawyers, and others; from State college and Department of Agriculture representatives, from bulletins and circulars, and from court opinions, laws, and other published material.

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Cover illustration.—Lawrence and his father talk over farm problems.

FATHER-SON FARM-OPERATING AGREEMENTS

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Contents

WHY A FATHER-SON FARM-OPERATING AGREEMENT?

MOST young men who want to begin farming today are faced with the problem of getting together enough capital to get started. Agriculture has become so specialized that more things for the farmer to use must be bought than was true a generation ago.

The census shows that from 1910 to 1945, the average value of all farms operated by their owners increased 39 percent. Not all of this increase came from a rise in the prices of land. The average size of farms that are farmed by their owners increased by nearly one-third. But with the greater use of tractors and power-driven equipment, the average investment in implements and machinery on such farms increased by almost four times during this same 35-year period. Livestock has become more important in farming systems during the last 35 years. This type of farming requires larger capital investments. In 1945, farmers' investments in implements, machinery, and livestock amounted to about a fourth of the value of all farm property.

To operate a farm today requires a large amount of capital even if the young farmer starts as a renter. Getting together the money necessary to equip a farm may take several years—years when a young man's physical vigor is usually greatest. A profitable farm business means hard work and good management; hence the chances for success are highest for the farmers who begin young. How to gain the first foothold on the ladder that leads to farm ownership is a really big question.

In contrast to the ambitious young men who want to get started in farming, there are the established farmers, past middle age, who would like to take things easier. The proportion of farmers who are farming their own land and are 55 years old or older increases with each passing generation. Figures in the 1945 census of agriculture show that in 1910, nearly a third of all such farmers were 55 years of age or older; but by 1945, somewhere near half were of this age.

Often these farmers do not want to retire to a place in town. They may not want to give up their farms and quit work entirely. Their interests are on the farm and for most of them this will always be true. Depriving them of the satisfaction of enjoying the fruits of their toil and efforts might easily shorten their life span. Most of them do not want complete idleness; they want to continue farming, with lighter work and with less responsibility for detailed management of the farm.

For the farmer whose son or son-in-law is interested in farming, a well-planned father-son agreement for operating the farm offers a solution to the problem of retirement. Young men who want to farm but who need capital to get started may find satisfactory father-son farm-operating agreements to be the answer. These arrangements usually permit the father to curtail his hard work but to retain his interest in the business. They may provide a way for the young man to get capital quickly and to begin farming on an established farm that calls for and rewards his best efforts.

The idea of fathers and sons working together on farms is not new. Parents have always helped their sons get started in farming. But in the last few years, more thought has been given to the best ways of doing this.

Agriculture today is a highly technical and complicated business. For this business to be successful, competent farmers are needed—farmers with special skills, management ability, experience, and confidence. Through father-son farm agreements many farmers are now providing their sons or sons-in-law an opportunity to develop these skills, to get experience in management, and to accumulate capital.

Farm agreements may also be used by persons who are not related but who want to operate farms on the same basis as fathers and sons. The large amount of capital needed to start farming may make this practice more and more desirable.

WHAT ARE FATHER-SON FARM-OPERATING AGREEMENTS?

Basically, father-son farm agreements are of two general kinds: (1) farm-**operating** agreements and (2) farm-**transfer** agreements. The two kinds can often be combined to advantage.

An operating agreement between father and son, or father-in-law and son-in-law, is an agreement to operate the farm business. (Such an arrangement is usually referred to as a father-son agreement, but it applies equally well to an arrangement between fathers-in-law and sons-in-law.) Such agreements may also be made between mother and son, or between mother-in-law and son-in-law. In other words, such agreements may be employed by various members of a family for operating the farm. In addition to the father and son, other members of the family—the mother, the son's wife, brothers, and sisters—have an interest because each may eventually share in the estate (fig. 1). Usually the estate is more valuable if the business remains intact under a father-son agreement than if the father retires, rents out the farm, and uses his operating capital in some other way.

Whether they cover a few or many details of the farm operation, agreements should be **written.** Many agreements are put into operation when the son is young—with a project or a minor enterprise; these agreements are informal. But when a son cooperates with his father on a full-time basis, a father-son agreement is usually drawn to cover all essential operating details of the business. These include the contributions of both father and son—labor, management, capital (real estate and operating), and expenses. Provisions for maintaining the farm and sharing in new investments and in farm receipts are generally included. Operating agreements apply to many types of farms, whether they are operated by owners or tenants.

A transfer agreement, on the other hand, sets up a definite arrange-

Figure 1.—The interests of all children should be carefully considered in forming a father-son farm-operating agreement.

ment for transferring part or full ownership of the farm to the son at some specified time, usually when the father retires or dies. Father-son farm-transfer agreements involve all members of the family. They should really be considered as family farm-transfer agreements. Both land and personal property may be included in them.

This bulletin deals with **farm-operating agreements only.**

PURPOSES OF FATHER-SON FARM-OPERATING AGREEMENTS

Fathers want to see their sons established in farming or in some other occupation or business. They want them to "stand on their own feet," but they realize that their sons need guidance and experience to face the problems ahead. Through the use of father-son farm-operating agreements many fathers are helping their sons to develop the interest, and to get the experience, training, and capital necessary to become successful farmers.

These agreements may serve many purposes. Here are some examples:

They Permit the Son To Get Training in Management From His Father

If, in working with his father, the son is allowed to make decisions on specific questions of management he can get experience and develop management skills. Keeping accounts, putting through money transactions, and carrying management plans into action, will give him first-hand knowledge of farm operations and a chance to develop initiative and confidence.

When he cooperates with his father in running the farm, he will soon have a feeling of responsibility. His interest in farming is likely to increase because he feels he "belongs" or is a partner in the business. With this kind of experience, he is able to develop his judgment and to learn how to handle his own affairs. These things should be of benefit even though he does not finally choose farming as his occupation.

Sharing in the business with his father encourages him to be thrifty and to save money. If he keeps the accounts he learns about the expenses and returns of various enterprises. He is able to see how the business is organized and how inventories and capital investments change from year to year.

The transition from boyhood chores to a share in the management of the farm business should be gradual. He might start with a 4–H Club project, a vocational agriculture project, or something similar. Later, he might be responsible for a specific farm enterprise. As his interest and experience grow, a shift from control of a single enterprise to a share in managing the farm is logical. He thus develops his skills and judgment at an early age.

They Give the Son a Chance To Accumulate Capital

When farming with his father, a son should be encouraged to acquire a share of the investment in the farm business. Accumulating capital step by step in the form of livestock, machinery, and other equipment makes it easier for him to save part of his share of the farm earnings. In contrast, if he is paid a cash monthly wage as a hired hand, he may spend it on his daily living—his incentive to save under such an arrangement is decidedly less.

The livestock and equipment he accumulates will furnish part of the necessary capital to get started if he later decides to farm for himself. If he decides against farming, the capital he has accumulated could pay for further education or it could help him get started in some other business.

They Provide Security for the Parents

Many farmers are not willing to give up their interest in a business that has taken them a lifetime to build. To rent the farm and move to town, as was often the custom a generation ago, is a severe strain on many older people. They find it hard to adjust to new situations and to develop new interests. To stop work altogether is an abrupt change for a farmer who is in reasonably good health. Too frequently he finds nothing to take the place of the work and problems on the farm. Without something to tie to he may be unhappy, his health may be affected, and his life may actually be shortened. A more sensible plan is for him to slow up his farm activities but to retain his interests and continue the work he feels like doing. At the same time, he will gradually turn over the main responsibility for labor and management to the son.

The father usually profits from this arrangement because the younger man often can keep the business at a higher level of production and so the total net income from the farm may even be increased. Both father and son benefit. At the same time, the father's interest remains in the farm. His mature experience and understanding help to keep the farm organization stable.

They Keep Up the Productivity of the Farm

Many farms are likely to run down as the owners grow older. A farmer past 55 or 60 may not have the strength to keep his farm at top efficiency. If his family is grown and his farm is paid for, his need for income may be less urgent. By bringing a son into the business he benefits by keeping it going well.

To accumulate a good herd of dairy cows, for instance, takes many years. If the herd is sold and the organization broken up, the farm income suffers until another profitable business can be gotten under way. When there is no father-son agreement this often happens. An operating agreement may help to maintain or perhaps to increase the total income from the farm, in which case both father and son will be better off.

When a son takes over the management and control of the farm he profits from its "going-concern value." That is, he takes over a business that is already on its feet and moving along. This is a big asset to a young man who is just getting started. If he had to "start from scratch" the business would have to be built up slowly. It might take many years to get it established on a sound basis. Knowing the right combination of enterprises for the particular farm will help him tremendously in avoiding mistakes.

GETTING STARTED WITH A FATHER-SON FARM-OPERATING AGREEMENT

Fathers and sons who are now working under successful agreements emphasize the importance of getting started early. The son should have an interest in the farm business as soon as he can look after part

of the livestock or one of the minor crops. He needs a stake in the business even though he is in school most of the time. His interest in farming, developed after school hours and during summer vacations, will be increased if he owns and controls even a small part of the business.

GROWING INTO THE BUSINESS

The son should have a chance to grow into the business. This growth may be gradual, changing its pace from time to time as his interests, skills, and experience increase. As he grows older, his responsibilities, duties, and returns should increase, and he should have a larger part in the operation and management of the farm. Habits acquired during his early years will go a long way toward success or failure in later years.

Pride in possession is a valuable asset. Owning and caring for a calf, a pig, or some chickens will give him experience in management. This kind of training teaches him to take responsibility and gives him a chance to learn whether he will like farming as a life work. If he does not like farming, making sure of this fact early in life may save painful changes later. However, allowing him full responsibility for a project is one of the best ways of helping him to like farming and see its possibilities.

STARTING WITH A PROJECT

The transition from the first boyhood chores to a real part in the management and even in the ownership should be made as soon as practicable. At first, the son might have a project or a single enterprise. Taking part in a 4–H Club or vocational agriculture project is a good way to begin. These projects are easy to set up, and the son can benefit from the supervision the project sponsors give him. But he might have a similar project not sponsored by any organization. It could be set up by the father and son. Many successful father-son farm-operating agreements have had their beginnings in such projects.

Sometimes 4–H Club or vocational agriculture projects are looked upon primarily as a way to raise a prize calf or pig or to produce a high yield of some crop (fig. 2). But these projects actually have much greater possibilities than such short-time accomplishments. Building the foundation for a sound farm-operating agreement can pay dividends long after the prize ribbons are forgotten. This is one of the long-time values of these early projects.

A good father-son farm agreement is likely to develop if the son is encouraged to use his project as a basis for building up a herd or flock. Income from crop projects can be used to help buy the equipment the son will need if he starts farming for himself. Expanding his projects in this way teaches him how to organize a farm business, it helps him to accumulate capital, and it develops confidence in his ability to manage an enterprise.

In helping a son to get established, the father's understanding encouragement may be worth more than assistance with money. With such encouragement the son feels that he fits into the business—that his knowledge, work, and experience are necessary in operating the farm. The performance of specific duties and the carrying out of specific responsibilities give him pride in jobs well done.

Figure 2.—A 4–H Club boy feeds his prize-winning calves.

Making it possible for the son to acquire special skills and earn his own way helps to build in him character which will be valuable, regardless of the occupation he finally chooses. If the parents rescue him every time he makes a mistake he will not learn the practical side of farming. It is better to let him "strike out for himself" even if he makes some mistakes. A few mistakes when he is starting out may not be serious and they may prevent more costly ones later on.

SHOULD THE SON STAY ON THE HOME FARM?

Although opportunities in agriculture are now limited, we hear a lot about keeping the son on the home farm. Many farm boys are not needed on farms and some do not want to be farmers. Then too, some farms are not suitable for two families. The problem is to provide a start for those boys who definitely want to farm. Father-son agreements can be made flexible enough to do this even though the son does not stay on the home place. If the father is still comparatively young when his son reaches the age at which he should begin farming for himself, he may want to help his boy get started on an adjoining or nearby farm. This is especially true for the older sons in a family of several children.

If the farm is too small or there is not room on the home place for all the sons who want to farm, then it may be best to help one or more sons to get started on another farm. This would be done only after they had had some experience and had accumulated some capital by

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taking part in a father-son agreement. By moving to a different farm an older son, for instance, would make a place for a younger son to enter into an operating agreement with the father. This arrangement could be followed for all sons, with probably the youngest remaining on the home farm.

Starting as a Tenant

It may be that the son who is ready to begin farming for himself can rent a farm. Perhaps he has accumulated enough livestock and machinery while farming with his father to partially equip a rented farm or has saved enough operating capital to be able to borrow the rest.

If he can rent a farm that is not too far from his father's, part of the specialized machinery both need might be used by both—particularly such machines as combines, corn pickers, and other harvesting equipment.

Starting as a Part Owner

If the son cannot stay with his father on the home farm, he may be able to start on his own as a part owner. If he has accumulated enough livestock and machinery to equip a farm and has some cash or can borrow advantageously, he may want to buy a small place with buildings, and then rent additional land to round out his farm unit. This kind of farming has many advantages when suitable land can be rented. Less capital is needed than when a full-sized farm is bought, yet many of the advantages of ownership are possible. Certain difficulties in keeping up and improving the buildings on leased land are avoided.

Working at Other Employment

Occasionally a son will get a job off the farm so he can save the money he needs to start farming. In this way some boys finance their share of expanded operations on the home farm or begin to farm on their own. But few boys who leave the farm intending to return ever go back to stay.

KINDS OF FATHER-SON FARM-OPERATING AGREEMENTS

The kind of farm-operating agreement to be used depends upon many conditions. Among these are the father's age, the son's age, the number and ages of the other children, the size and type of farm, the son's experience and training, the financial position of each party, and the contributions each can make, such as real estate, personal property, labor, management, and payment of expenses of the farm. Each agreement should be fitted to the particular situation.

The agreement used by one father and son may differ from that used by their neighbors. But it should fit the particular situation. This discussion cannot point out definitely the kind of agreement that should be used. How to share ownership, income, and expenses, or arrange other details, is for the individual father and son to decide. The kinds of agreements most commonly used are described and ideas that fathers and sons have included in successful agreements are listed. From these suggestions, fathers and sons should decide, after talking it over thoroughly, the kind of agreement that is suited to their particular conditions.

As the son grows older or conditions make it necessary, father-son farm agreements should be changed. Studies show that many agreements that were made while the son was young have matured to full partnerships, and then resulted in the son's ownership of the farm. A study of father-son farm agreements made in South Dakota in 1947, indicated that about 40 percent of the sons started out by sharing in part of the livestock or crops. From an early beginning with a 4–H Club or vocational agriculture project many sons had expanded their operations into full-time business. A study made in Virginia in 1949, also showed that many agreements had gone through a gradual development from the simplest form to a share in the entire business. Not all sons enter agreements at an early age; many start at various ages, depending on circumstances. A boy need not pass through all stages. (The published reports of these and other studies, mentioned in this bulletin, mostly made by State agricultural experiment stations, are listed on p. 36.)

These operating agreements are often classified on the basis of contributions by father and son to, and their returns from, the farm business. This classification is influenced by the particular items and the proportion of these items that each furnishes to the business—real estate, personal property (operating capital), labor, management, and operating expenses; and the returns received—such as wages and share of income. Under this classification, which depends on both business and legal factors, the usual kinds of agreements are: project, enterprise, joint operation (including partnership and corporation), wage and income sharing, lease, and combinations of these kinds. The legal relationship established by the various agreements is discussed on pages 31 to 35.

PROJECT AGREEMENTS

Project agreements are usually informal. They start while the son is young so that his interest may be developed early. An agreement of this kind may begin with the father giving his son a calf, a pig, or some chickens. On a crop farm, the son may be put in charge of the garden, or given all or part of some minor crop on which he does most of the work. A 4–H Club or vocational agriculture project may begin as soon as the boy is old enough to take an active part in these projects.

The project agreement should be regarded as only a starting point. As the son grows and is ready for more responsibility, he should take more part in the farm business and his share in the income should be larger.

ENTERPRISE AGREEMENTS

The logical thing to do when the son outgrows the project stage is to let him take the responsibility for an enterprise. At first the agreement might be limited to a single enterprise suited to the amount of time he can give to it. His interests, abilities, and judgment should be carefully considered in deciding which enterprise to share with him. The poultry flock, the dairy, or the tobacco crop, might be appropriate.

The share of the income he receives from his enterprise may be based partly on labor, management, and capital he puts into it. He

should be encouraged to develop a herd or flock, or to invest his earnings in machinery or other equipment. This should lead to a gradual accumulation of capital in either property or money. Meanwhile he will be developing skill in management and getting practical farm business training. From this kind of agreement, father and son should look forward to the time when they will be joint operators of the whole farm, or to the day when the boy can begin on a farm of his own.

In planning ahead the need for the son to complete his schooling up to some certain point should be considered. If he is to go to college, he might arrange to use some of his savings or sell some of his livestock or equipment to pay part of his expenses. The agreement would need to be planned to fit the situation. Possibly he could keep on with his enterprise while he is in school. By working during the summer vacation and keeping the agreement going he should be prepared, when he is graduated, to take a full-time part in operating the entire farm.

In most cases, project and enterprise agreements should be considered as apprenticeship arrangements leading to something more. They do not develop a well-rounded interest or skill in all phases of farm management. Too often a father with a mature son delays the change to full-time joint operation or a partnership agreement. The son is likely to find this discouraging.

JOINT-OPERATION AGREEMENTS

When the son has had experience and is ready to devote full time to farming, an agreement for joint operation may best fit the situation. Such an agreement provides for joint management and control by father and son. The control may come from joint ownership of the personal property, or from both taking active part in the farm work.

By the time the son is ready for a joint-operation agreement he may have considerable capital—livestock, machinery, or other personal property. This will be particularly true if he has been working under an enterprise agreement for several years. But if he does not have a substantial amount, he may wish to buy a part interest in his father's personal property in order to have a half interest or some other definite share in the operating capital.

Ordinarily, in the beginning stages of a joint-operation agreement, the father continues to own the real estate. As owner of the land, he may receive interest on his investment based on its estimated value. By another method, father and son rent the farm from the father at an agreed rental. Frequently, the joint operators rent the father's land on a 50–50 crop-share or livestock-share lease. Thus, on the one hand, the father is a landlord in respect to the joint operation and receives rent for the use of his land. But on the other hand, as one of the joint operators, he receives a share of the farm earnings as decided upon in the agreement. In either case, if he is paid for use of the real estate he is expected to pay the taxes, the upkeep, and other expenses on the land and buildings. Generally, increases and decreases in inventories of livestock, machinery, and other operating equipment are shared in the same proportion as the income is shared.

If the father can afford to do so, he may contribute his real estate at a nominal figure to help build up the boy's share of farm income. If the farm is free of debt, this would not cost him any cash as he would merely forgo the interest return or rent from his investment. In this case, the son would probably he expected to pay part of the taxes and other cash expenses on the real estate.

The basis of joint ownership and sharing may be one-fourth, one-third, one-half, or any other proportion that is satisfactory to both. A rough approximation for sharing income may be worked out by making the share each receives proportional to the amount he contributes. For example, if the value of the son's contributions in the form of capital, operating expenses, labor, and management equals 50 percent of the total contributions, then he would receive 50 percent of the farm income. This method is often used by landlords and tenants in figuring the rent to be paid for a farm. The method should be varied to suit individual needs and wishes. Because a father-son agreement is between members of the family, the father may want to give his son a better deal than is customary in farm leasing.

Some of the agreements provide for dividing the net farm income on a profit-sharing basis. Under this scheme, each is paid for what he contributes to the farm business. Then, when the value of all contributions and the farm expenses have been deducted, the remainder is divided between father and son as agreed, on a 50–50 basis, or whatever the percentage agreed upon.

Partnership Agreements

Agreements for joint operation may or may not be regarded by the courts as legal partnerships. Partnerships depend upon the way the joint business is organized and operated. In a genuine partnership each partner may legally act as the agent of the other. Both are liable for any obligations of the partnership. Much of this discussion of joint-operating agreements also applies to partnerships.

A study in Michigan in 1944 seemed to show that most fathers and sons have confidence in each other and that they do not concern themselves with whether or not their joint-operation agreement is a partnership. But they should know about the liabilities of a partnership so they can plan their agreement accordingly. If they think it desirable that the agreement should not be considered a partnership, certain steps can be taken to help prevent this. The legal problems that arise from this kind of agreement are discussed on page 32.

Corporation Agreements

Under certain circumstances, a father and son may want to incorporate to carry on the joint operation, if their particular State permits farming corporations. But in general the corporate form is not used unless the business is large and complicated. Incorporation may be feasible when father and son are conducting a specialized commercial business, like the production of hybrid seed, or operating an orchard or a retail milk route. Maintaining the continuity of the business, its name, and perhaps the organization, may be the only way to retain the good will and the going-concern value. This continuity may be maintained best through incorporation.

A corporation may have advantages over a partnership with respect

to liabilities. The stockholders of a corporation generally are not personally liable for its debts and obligations, as is true for a partnership. Legal advice is needed to organize a corporation, as certain facts and legal forms must be supplied to the State before a charter can be obtained. The double-tax angle should be considered before deciding to incoporate, as income taxes might be higher under a corporation than under a partnership or other kind of father-son agreement. We discuss these problems on page 35.

Agreements for joint operation represent a mature stage in father-son operation of the farm. Usually they are drawn up after the son is old enough to have gained valuable experience and to have saved some money to invest in the business. His regular schooling has usually been completed and he can spend full time on the farm. So he is prepared to take over a larger part of the management. By this time, the father may have reached the age when he wants to "slow down and take things easy." Joint-operation agreements pave the way for passing the responsibility for management and actual farming to the younger generation.

WAGE AND INCOME-SHARING AGREEMENTS

If the son's part in the farm business does not start in early boyhood, a wage and income-sharing agreement may be suitable. He could be paid a monthly wage plus a share in the net farm income from an enterprise, or preferably a percentage of the income from the whole farm. Part of his share of the net farm income might be paid to him in the form of certain livestock, machinery, or other equipment.

The wage agreed upon might be the going rate for the community or possibly slightly lower if the son also receives a share in the net farm income. Because of his interest in having the profits as high as possible, he is likely to do his best to keep the costs down, as well as to increase the total income. As a result, the net income to both father and son is increased in many cases. The son has a special reason to work steadily and to take the viewpoint of a manager rather than of a hired hand.

The wage and income-sharing agreement, however, should be regarded as temporary. If father and son continue to farm together they should transfer to a joint-operating agreement. A wage and income-sharing agreement may apply to cases in which the son has been away from home for some time—in the armed forces, at college, or working off the farm. Also this kind of agreement may be used when a married son returns to the farm. He may need cash for immediate living expenses that could be supplied by the father in the form of monthly wages. As he may not have the money to buy a share of the operating capital, his contributions to the business would be mainly his labor and whatever management he can furnish.

An agreement of this kind may serve as a testing period for the son. During the time the agreement is in force, he and his father can find out whether his interest lies in farming.

LEASE AGREEMENTS

A farm-lease agreement may best fit the situation when the father does not want to continue taking an active part in the management and work of the farm. Under a farm-lease agreement, the operator

(son) usually provides all or most of the labor and management and often supplies all or part of the equipment as well. If they operate under the usual cash or crop-share lease, the father would ordinarily exercise little management control over the farming carried on by the son as a tenant. But in some livestock-share leases the landlord (father) may take part in some of the management decisions and may still own part of the livestock and equipment.

If a father and son decide that their agreement should be a lease, they may want to see two publications: *Your Farm Lease*, Miscellaneous Publication 627, and *Better Farm Leases*, Farmers' Bulletin 1969, issued by the United States Department of Agriculture. The Department also has a *Standard Farm Lease* form that is applicable to most rental situations. These publications and the lease form may be obtained free from the county agricultural agent or by writing directly to the Department of Agriculture, Washington 25, D. C. The State college of agriculture and the county agricultural agent may have other farm-lease bulletins and farm-lease forms that fit the case.

COMBINATION OF TYPES

Frequently, fathers and sons use parts of several kinds of agreements when they are drawing up one that fits their particular needs and wishes. Often they are less concerned about the kind of agreement used than with adapting it to meet their own needs. If the agreement includes all necessary items, its form may not matter very much. However, father and son should know the liabilities that might be involved and the precautions that may be taken in connection with the particular agreement they prefer, as discussed under "Legal considerations," page 31.

FATHER-SON FARM-TRANSFER AGREEMENTS

Although this bulletin is not concerned with transfer agreements, they are mentioned here as some readers may wish to inquire about them elsewhere. Several State colleges of agriculture have bulletins on this subject. Readers can write to their respective agricultural colleges or county agricultural agents for this information.

A father-son farm-transfer agreement is a plan for transferring ownership of the farm as a going concern to the son who is farming it. This agreement may take many forms. It may call for either immediate or gradual transfer of ownership to the son while the father is living, or it may specify certain conditions for transfer at his death. For example, it may provide for outright transfer to the son at his father's death, or it may provide for payment for all or part of the farm through a purchase-contract arrangement or mortgage. Provisions for payment for the shares of other heirs, the care of the mother, and other details, may be included. The main purposes of transfer agreements are to assure the son who operates the home farm protection against loss of his equity in the business and to provide security for the parents in their declining years.

A father-son farm-transfer agreement combined with an operating agreement assures continuous operation and often makes it possible to conserve the farm and to maintain its production while control and ownership are passed from one generation to the next. Neglecting to

work out a satisfactory transfer agreement may leave a son in an uncertain situation when the family estate is settled.

SETTING FOR FATHER-SON FARM-OPERATING AGREEMENTS

Under what conditions are father-son farm-operating agreements most likely to be successful? What are some of the problems connected with their use? How can some of these problems be solved?

A study made in North Dakota in 1941, shows that the success of a father-son farm-operating agreement depends on three factors: (1) The capability of the farm to provide for more than one family; (2) the willingness and ability of father and son and other members of the family to cooperate and to appreciate the possible advantages of an operating agreement; and (3) the question of providing separate housing if both partners are married.

THE FARM

Not all farms are suitable for the development of father-son operating agreements. Some units are too small, some are not productive enough, and others are so poorly organized that they do not return an income that will support two families. Some farms are so located that they cannot be made into the kind of units upon which a son would want to spend his life and rear a family. However, certain plans may be followed to increase the size and change the organization so that many farms not now suitable can be adapted to father-son operation.

Size of Farm

Most farms with father-son operating agreements are larger than the average for the community they are in. Of the 61 farms operated under father-son agreements surveyed in a study made in Ohio in 1946, only 6 had less than 100 acres. Of these 6 farms, 4 were intensive truck-crop and fruit farms. The accounting records showed that farms with father-son agreements averaged about a third larger and had about a half more income than farms without agreements. So those making the study concluded that increased size of business under father-son agreements is attained partly by farming more land and partly by more intensive use of the land.

A similar relation was observed in Virginia. Farms with father-son agreements averaged 278 acres. These farms were more than twice as large as the average of all farms in the county in which the study was made. The farms operated by fathers and sons had an average of 40 animal units of livestock, indicating that they were intensively operated.

If a farm business as now organized is too small to provide a satisfactory income for two families, it may be possible with the son's help to reorganize and enlarge it. One way to make the business larger is to rent additional land, but this cannot be done in all areas.

Frequently the size of the business may be increased by applying more labor and capital. Enterprises that use more labor may be added and more fertilizer, better seed, or improved breeding stock may be used. When the son devotes full time to the business, a poultry flock or a dairy herd might be added. The use of capital to

apply limestone and fertilizer, and to grow cover crops, may increase the productivity of the farm so that the same number of acres will support two families adequately, instead of one. More complete use of the available land through drainage, clearing, or irrigation may improve the farm's earning capacity.

Adding certain livestock enterprises to the farm often brings about a better use of labor. These additions require capital. But if the full-time agreement has grown from a project or enterprise arrangement and the father and son have planned ahead, the son may already have the animals that will form the basis of a herd. This method of changing the farm organization to fit the increasing need for income, as the son takes a greater part in the business, should be kept in mind as plans develop. Pastures might be built up gradually as the son's breeding herd increases. "Growing into" a new enterprise is often better than "buying in."

Sometimes the size of business may be increased by increasing the number of processes carried out on the farm or by furnishing more services than are usually provided. For example, a shift might be made from the sale of milk for manufacturing to selling to a Grade A dairy. Or eggs, vegetables, fruits, or other products might be packaged on the farm and sold at retail.

Type of Farm

Certain types of farms appear to be better suited to father-son operation than others; for example, dairy farms rather than cash-crop farms. This does not mean that agreements are not found on crop farms—there are many successful examples. But in many cases arrangements on cash-grain farms take the form of crop-share leases rather than joint-operation agreements between father and son.

On livestock farms agreements can be made that lead to joint operation or full partnerships. The boy who starts with a heifer or a sow can more readily accumulate capital. If he saves his breeding stock he may, with his father's cooperation, build up a herd within a few years. In contrast, a son on a cash-grain farm does not have the same chances to see his money grow. Ordinarily, he invests his savings in machinery and equipment and they depreciate rather than grow in value through the years.

The special skills that are needed, together with the high wages demanded by men who are qualified to work on a dairy farm, is probably one reason why father-son agreements are likely to be particularly satisfactory on dairy farms. A son who has an interest in the business is likely to make the best kind of help.

Mortgaged Farms

Adjustments needed in the farm organization to establish a full-time father-son operating agreement are easiest when the farm is not heavily mortgaged or is owned free of debt. In this case, the interest and principal payments on real estate investment may not be an important cash expense. Therefore, some fathers may want to leave this bookkeeping item out of the calculation of contributions to farm expenses. This allows the son to share in the returns from the real estate, thus increasing his part of the farm income. It is a good plan to keep the other children in mind if concessions are made to the son who does the farming. By keeping the others informed concerning

the reasons for terms of the agreement, future misunderstandings may be avoided.

If the farm has a considerable mortgage the situation may be different. Many fathers and sons have been successful in working out agreements on mortgaged farms, but principal and interest payments complicate the agreement. They must be paid in cash and they become a farm expense. Because the retirement of the debt and payments of interest must be made regularly, the farm will probably have to return enough income to carry this expense. This fact should be considered when plans are made for joint operation.

If interest and principal on the mortgage are paid from joint earnings, special recognition of the son's contribution to retirement of the debt should be made. He may be considered as buying a share in the real estate when he helps to pay off the debt. An understanding of the amount to be paid by him and the method by which he is to be compensated should be reached, put in writing, and signed. When the mortgage is fully paid, the father may want to give the son a deed or other written indication to show to what extent he has bought into the farm. Unless the son has something in writing, signed by his father, to show his contribution to the retirement of the debt, his investment may be lost at his father's death, particularly if there are other children to share in the estate. Several ways of compensating the son are possible—for instance, giving him a note or a mortgage. A lawyer could help arrange a satisfactory method.

Rented Farms

Operating agreements may be used successfully on rented farms if the size of the business is adequate and, in addition, the income is sufficient to pay the rent and furnish a living for the families of both the father and son. The landlord will receive his rent (in cash or kind) regardless of the amount of income left for father and son to divide. The organization may not be as flexible on a rented farm as on an owned farm; however, details of the agreement may be similar to those used on farms operated by owners.

An agreement between father and son on a rented farm could give the son the same chance to get experience in managing and operating that would be possible if his father owned the farm. Although the opportunities to accumulate capital on a rented farm may be limited, a way can usually be found for the boy to own some livestock, machinery, or other operating capital. The object of the agreement may be to help him get a farm of his own, rather than to keep on with his father as is usually the case when the father owns the farm.

THE FAMILY

If the father and son can "give and take" and will consider each other's point of view their agreement is likely to be successful. The attitudes of the mother and the son's wife are also important. If the younger woman likes farm life and has a real interest in the farm business, an agreement is likely to work out well; otherwise not.

The father must be sufficiently wise and open-minded to recognize the son's maturity and increasing ability. The son must have confidence in and respect for his father. The imagination and enthusiasm of the son together with the mature judgment and experience of

the father can work for the benefit of both if both are patient and if each learns to appreciate the value of these qualities in the other.

Father-son farm-operating agreements are easier to start when there is only one son or only one who is interested in actually working the home farm. Most parents want to treat all their children alike, if possible. The son or son-in-law who farms with the father or father-in-law may be regarded by the other children as getting "more than his share," especially if there is also a transfer agreement providing that he is eventually to own part of the real property. The children who are not working on the farm may forget the parental help they had in getting advanced schooling, or in getting started in a job or business of their own. Then, too, they may not realize the part the operating son plays in assuring the welfare and security of the parents as they grow older. The other members of the family, also, are likely to think of the farm as it was when they were at home before the son took over and to feel that they should have their full share of the estate.

Usually a farm that is worked under a father-son agreement is kept more productive than if the father in his old age operated it alone or rented it to an outsider. Many of the contributions—such as improvements of land, repairs to buildings, and maintenance—made by the son add to the value of the farm; yet his brothers and sisters may fail to realize this fact and also the fact that they have not contributed to this advancement in value.

When there are two or three sons who want to farm they might all be brought into the business if it is, or can be made, big enough to accommodate them all (fig. 3). This might be done by renting or buying additional land. Or the sons might "graduate" from the home farm to other farms in the community. The oldest son might accumulate enough capital and equipment, through taking part in an operating agreement, to start on another farm by the time a second son is ready to work full time with his father. If the boy who leaves the home farm can rent or buy in the community, his father may be able to help him in ways that do not involve the expenditure of cash. They might exchange work in haying, corn picking, or tobacco harvesting, and might lend equipment to each other.

THE HOUSING SITUATION

If the farm does not already have two houses the question of additional housing is likely to arise when the son marries. Housing should provide privacy for each family, should be comfortable, should be adequate in terms of local housing standards and should, if possible, reflect personal preferences in housing of those concerned. Most people believe that "no house is large enough for two families," especially in farming where it is hard to separate the home life from the business. Careful consideration should be given to the advisability of having separate living quarters for the two families.

Some parents and their children's families live together in harmony. But the chances for success on a cooperatively operated farm are greater when each family has its own living quarters. The importance with which separate housing is regarded was illustrated in the study in Ohio. Of 45 married sons included in the sample group studied, 39 had separate housing.

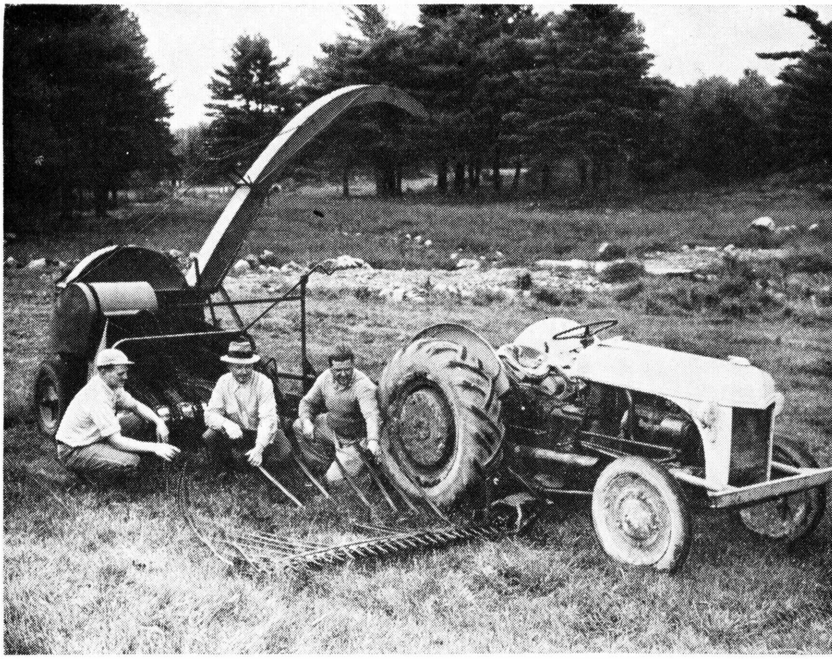

Figure 3.—Father-son agreements may be used when two or more sons want to farm with their father.

Among the ways of providing living quarters for another family are: (1) Remodeling or refurnishing a tenant or hired hand's house or other building on the farm, (2) building a new house, (3) renting a nearby house, and (4) converting the present house into two apartments.

Remodeling House or Farm Building

If there is a tenant house on the farm, it might serve the purpose, or it could be remodeled so that it would be suitable. Possibly some other farm building, such as a garage, could be remodeled to provide separate living quarters for one of the families. Many attractive city apartments have been made from remodeled garages.

Building a New House

If the farm is large enough to need two men for efficient long-time operation, perhaps a new house could be built. However, if the farm is not this large, a second house might be a poor long-time investment.

If a new house is to be built, its location should be carefully planned. If the farm is to be divided sometime in the future, the location of the house should be chosen with that in mind. The new house should be situated so that it will be convenient for doing the usual farm chores. On the other hand, it may be well not to have the two houses too close together.

Which family is to occupy the new living quarters is a matter for mutual agreement. The particular housing needs of each are to be thought of in making this decision. Perhaps a compact, smaller house

would suit the parents if they have no children at home. It may take less work to keep it and this might be a help as they grow older. Meanwhile, the son and his wife may need a relatively larger house, particularly if they have a growing family. Costs of building a new house or of renting a house may be less for a house that is suited to the parents' needs than for one suitable for a young couple with several children.

If a second house is decided on, who should have the responsibility for building it? Who should bear this expense? Usually a house is supplied on a rented farm. Would this method be fair when the son operates the farm in cooperation with his father? The future interests of the persons who pay the cost of building should be protected. If the son pays part of the cost, his interest might be protected by selling or otherwise transferring to him the tract of land on which the house is built.

Renting a House

If building an additional house is not practicable, it may be possible to rent one. This might be a house on another farm in the community, or one in a nearby town, if it is not too far from the farm.

In renting an additional house for either father or son, responsibility for payment of rent must be agreed upon in advance. As full-time cooperators, both would be entitled to receive their living quarters from the farm business. Therefore, it seems reasonable to assume that the rent on the additional house would be paid out of the farm income before it is divided; although this decision must be based upon the individual circumstances.

Converting Present House Into Two Separate Apartments

If the house is large enough to be divided, this plan might be followed. It should also be considered when the parents are old and need a younger person near. If this plan is put into effect, it is usually well to have the apartments entirely separate, with separate entrances, kitchens, and bathrooms. This is especially true when the son has young children who might disturb the parents.

DETAILS OF THE FARTHER-SON FARM-OPERATING AGREEMENT

Up to this point attention has been centered on the general problems and ways of setting up a father-son farm-operating agreement. In this section, we consider the details of the agreement.

What are the bare essentials? What are the items that must be decided upon? What things should each party contribute to the business? How should these contributions be valued? What provisions should be made for sharing ownership in any increase in inventory and in improvements? How should expenses and receipts be shared? These are a few of the things to be considered carefully in setting up an agreement. Not all of these questions can be answered here. Only father and son can do that after considering the forms of agreement available to them. In this section we call attention to some of the ways in which the decisions may be made. Fathers and sons should think about and discuss these details, and talk them over with their county agricultural agent or some other person who can give technical assistance, before they decide how the agreement is to be drawn up.

CONTRIBUTIONS TO THE BUSINESS

A father-son farm-operating agreement should be set up in a businesslike way. It should cover all essential parts of the farm business—land (real estate), capital, labor, and management. How these items are shared on a particular farm depends upon the purposes, needs, and wishes of the people concerned—the parents, the son and his wife, and in many cases, the other members of the family. One way would be to divide the farm income in the same proportion that contributions are made to the business. By this method, if father and son each pays half the costs of operation, they will share the income on a 50–50 basis.

In a study made in Ohio, it was found that only a few fathers thought their agreements should be on a strict business basis; that is, that the son should take part in the business much like an outsider. Those who were of this opinion believed that special favors to the son "would lead to softness and inability to meet periods of adversity." But most of the fathers took the opposite stand. They thought that the agreement should be much more favorable to the son than the typical leasing arrangement.

Why should the son get a "break" when he cooperates with dad in operating the home farm? Some who have studied the matter justify the practice because: (1) The son may have worked hard during his childhood; hence some benefits are due him for that reason; (2) he takes on more responsibility and takes more interest in the success of the farm and the welfare of his parents than could be expected from an outsider; (3) it is expected that he will repay the parents by relieving them of burdens and responsibility and helping to maintain their security; and (4) some parents can afford to give their sons a better break than they themselves had.

Among the suggested ways of helping the son were: (1) Give him a larger share of receipts than he would get in a typical lease arrangement; (2) make adjustments in sharing expenses and authority as he grows older; and (3) furnish him, if he is not married, with lodging, board, and laundry, without charge.

Being businesslike does not necessarily mean that receipts should be shared in the same proportion as contributions. But it does mean that each item in the agreement should be talked over and thought out before it is agreed to. Each wants to know definitely what he is to contribute and what he is to receive. Being businesslike means being definite rather than allowing things to go along without having a clear-cut understanding.

In the early stages of an agreement, while the son is still in school, he probably has little except his labor to contribute to the farm business. Later, as he accumulates some capital of his own, this could be added to the contributions that are needed by the farm. As he gains experience, he should be in position to help manage the farm. This also would increase his total contribution. As his contributions to the business increase, his share of the farm income should be proportionately larger.

Real Estate

In making contributions to the business the father is usually in a better position to furnish the real estate. This is true even after

the son is participating full time as a joint operator in the business. If the land is rented, then the son should contribute his proportionate share to the rental, either in cash or a share of the crops.

Good business methods indicate that a value should be put upon each contribution to the farm business. One way to estimate the value of land and buildings is to do as many mortgage lenders do; that is, to base the value on the long-time earning capacity of the farm. The interest rate charged on this earning-capacity value might be the current rate on long-time mortgage loans. This method eliminates any wide fluctuations in contributions because of the changes in price of land. Another way of valuing the contribution made by real estate is to base it on the rental rate for comparable land in the community.

If the father, as owner of the land, pays the costs for new buildings or other major improvements, the valuation of his contribution of real estate should be adjusted accordingly. If the son pays part of the costs, an arrangement should be made to protect his investment in case the agreement is terminated. A signed note, or a mortgage, or a deed, are arrangements to be considered.

As owner of the land and buildings, the father may expect a return from their use in the form of interest on the investment, or rent. If he receives rent for real estate, he would be expected to pay taxes, insurance, upkeep, and other expenses on land and buildings. If the farm is mortgaged, the interest charge is a cash expense to be paid by the father from his return on investment, or from joint earnings. But if the farm is free of debt, the investment charge for use of real estate need not necessarily be regarded as a cash cost.

The help a father can give his son in getting started depends upon his financial position, the needs of other members of the family, and other personal matters. What the son gets as a gift can be decided only by the parents in each particular case. No general rule applies to all families. But for the parents who own their farm and want to give their son a break, one way is to furnish the land without taking rent or interest as a return for their investment. If this is done, the cash costs of ownership—taxes, insurance, and maintenance expenses—can be shared. Furnishing the land would cost the father only his share of the fixed expenses, but it would be a big help to the son.

Personal Property

In the early phases of an agreement, the father may furnish all or nearly all of the personal property. However, the expectation should be for the son gradually to accumulate livestock and equipment. The son who starts with a project or enterprise agreement at an early age will probably have accumulated considerable personal property that can be put into the business when he joins his father on a full-time basis.

Ordinarily, the son would expect to share in proportion to his contributions to the business. If it is agreed that his share should be 50–50 with his father but he does not own half of the personal property, he may want to buy a part interest from his father to make up the difference. Sometimes fathers sell their sons an interest in the livestock, power equipment, or other personal property, and take notes for the debt. In these cases, the son usually pays interest on the note

and retires the principal from his share of farm earnings. Thus, he may become a full partner earlier than if he had had to save the entire amount before going into business with his dad.

Under certain circumstances some fathers agree to give their sons a half interest in the personal property when the full-time agreement begins. Others take a non-interest-bearing note. These are family affairs, and anything that is mutually agreeable between parents and children can be worked out. It may be a good plan for parents to help the son, but they should keep in mind that the development of his self-reliance and confidence is important.

A complete inventory of all personal property should be taken when the full-time agreement begins. It should include all livestock, machinery, equipment, feeds, and supplies. A monetary value should be placed on each item and a record of the ownership should be kept. Written evidence of ownership interests is especially important in the event either party should die. Father and son should cooperate in making the list and in estimating the values so that they will agree on each item. Farmers' Bulletin 1962, *Useful Records for Family Farms*, states that values to be placed on personal property may be estimated by using: (1) The original cost of the item reduced by wear and tear (depreciation), (2) the market price, if it were to be sold at a farm sale, or (3) the value of the item based on its current worth to the farm operation, or its replacement cost. In evaluating machinery and equipment, it is generally acceptable to use the estimated farm sales values, or the depreciated inventory book values. The values for livestock, feeds, and supplies are usually based on current market prices.

In valuing home-raised breeding livestock it may be well to estimate average values based on some previous period, say the last 10 years. It is a good plan to agree to maintain these values from year to year, as inventory changes would then be based largely upon increases or decreases in numbers of animals rather than upon fluctuations in prices.

Labor

Usually both father and son contribute their labor to the farm business. In the early stages of the agreement, while the son is young and works only part time on the farm, his labor would probably be valued considerably below his father's labor. But by the time he is ready to work full time it may be worth more than his father's. The estimated value of labor done by father and son should be decided upon according to the particular current situation. The customary rate for hired labor in the community can be used in making the estimate. Whether to use the prevailing wage rates or a long-time average should be decided. This might depend partly on the basis that is used in valuing real estate. If long-time earning-capacity values were used to value the real estate then it might be appropriate to use an average wage rate, say an average for the last 10 years. The valuation decided upon should be one that both father and son think is fair.

If it should become necessary or desirable for one of the joint operators to work off the farm part or full time, it is usually best that the father do this. This may fit into his plan to take things easier by turning over more of the farming to his son. The older man may

find a lighter job off the farm—such as serving on a county agricultural committee, or perhaps selling insurance, or machinery, or feed. He may still be able to help out on the farm during rush seasons, or with the chores. If either father or son works off the farm part of the time, his labor contribution to the farm business is likely to be decreased; if so, adjustments can be made from time to time to fit changing conditions.

Management

It is rather hard to decide on the value to give to management. The contribution it makes is not easy to see. Perhaps it would be best in most cases to assume that management is contributed jointly by father and son, and make no attempt to put a money value on it. Good management makes a big contribution to the success of the farm business, but in a father-son farm-operating agreement it is not necessary to account in detail for every item of noncash expense. The idea is for the son to take a substantial part in the management of the farm. This will come about as confidence is built up under the patient guidance of the father.

Some fathers may find it hard to rely on their son's judgment at first, but if the agreement has progressed through the project and enterprise stages, the son probably will have learned to make wise decisions in management. A son who is encouraged by his father to take responsibility for a project or enterprise learns to make small decisions at first which help him to think things through when he later assumes part of the responsibility for managing the farm. This early training period for the son should prove advantageous to both father and son. The father should try to see the situation from his son's point of view. The son will want to use his initiative in making management decisions, and this is the way he learns. He should be allowed to try some new things and should be responsible for their success or failure, within reason. If they are successful, the wise father comments on his ability. If the venture is a failure, the wise father is sympathetic and offers suggestions that will help his son to see any mistakes he may have made, before he tries again.

Often the son has learned of new developments in agriculture through his high-school or college work, or through his reading, or at meetings. He may be acquainted with new cultural practices, improved varieties of crops, new kinds of seed, new ways of using fertilizer and improved livestock rations. The father should let him try new methods and new ideas. At the same time because of his mature judgment and longer experience he can guide his son in following a reasonable course.

OWNERSHIP IN INVENTORY CHANGES AND IMPROVEMENTS

The father and son should decide how changes in inventory are to be shared. In connection with personal property, increases and decreases in inventory numbers or values are usually shared in the same proportion as expenses and receipts. If all the land belongs to the father, increases and decreases in its value are generally his.

A question often arises concerning improvements on the father's land. Under a joint-operation agreement, if the son helps to make improvements to the land or buildings, or pays part of the costs of

new buildings and fences, his investment should be recognized and protected. Over several years, the productivity of the farm may be built up by adopting soil-conservation practices and measures, adding fertilizer, and developing pastures. When the son has helped to make these improvements by contributing labor, management, and operating capital, he should share proportionately in the benefits of the improvements.

Careful records should be kept to show the contributions made by the son to improve land owned by the father. An agreement should also be reached, put in writing, and signed, specifying how the son is to be compensated for these contributions. One way is to transfer to the son a share in ownership of the real estate. This is sometimes advisable because other children in the family may be inclined to disregard or to underestimate the value of improvements that the son has helped to bring about.

As a basis for agreeing upon a value of the son's contribution to real estate improvements, one of the following may be used: (1) The cost of the improvement based upon a detailed record of expenditures—the son's labor should be considered in calculating these costs; (2) the replacement cost according to an appraisal at the time settlement is made; (3) the depreciated value as followed in income tax reports, or (4) the added value at the end of each year. This would be an estimate of the value of the improvement to an incoming operator—that is, the value to a new operator if he were to take over the farm with the improvement.

OPERATING EXPENSES AND FARM RECEIPTS

During the project stage of an agreement the father may furnish feed, fertilizer, or other supplies to support the boy's project. If it is a livestock project, the animals may be fed from the father's home-produced feeds. But it may be thought desirable for the son to pay for the commercial feeds and special supplies he uses. This will give him early experience in handling money and paying the expenses of a business. In fact, one of the chief benefits to him may be the experience he gains in keeping account of all expenses. This experience may be lost if his father gives him all the supplies for his project.

Whether the son should pay for home-grown feeds depends upon his and his father's preference. If the boy does chores and helps on the farm when not in school his father might consider that he has helped produce the home-grown feed and so is entitled to use part of it to feed his project livestock. As the son progresses from the project stage to an enterprise agreement, changes may be made in the arrangement.

Usually in the early project stage of an agreement, the son would expect to keep all the income from his project. This might also be true for a minor enterprise, especially if he has paid the cash expenses connected with it. But if part of the expenses are paid by the father he may naturally have part of the receipts.

Expenses that are not in cash, such as use of barn or pasture for a cow and calf, would ordinarily be furnished by the father without cost. On a crop project the father may be justified in having a share of the receipts if he prepares the land, buys the fertilizer, and pays other cash expenses. How these items are shared depends upon what

the father thinks will give his son the kind of experience, training, and incentive he needs to develop into a full-time partner.

As the agreement progresses to full-time joint operation the expenses are shared. The part paid by the son will depend upon the particular circumstances and the wishes of himself and his father. Usually, important purchases and sales are made only after they talk them over together. Either, or both, may be empowered to pay the regular operating expenses. To avoid misunderstanding later they should agree in advance as to the method to be followed.

Arrangements may be made for making regular withdrawals from business income to meet personal expenses. These withdrawals may be regarded as payments for labor at a specified monthly or weekly rate or they may be a flat sum to cover living expenses. Instead of depending on week-to-week decisions an agreement should be reached concerning an amount to be taken out regularly. Too many agreements fail to specify how family living expenses are to be met and the son has to ask for the money he needs. This should be avoided. The son should not have to ask his father for money he has already earned.

Farm Records

Any well-organized farm business should keep a set of written records. These records might include an itemized account of receipts and expenses (including capital outlays), a property list or inventory, and an account of production and performance (yields, livestock gains, and related information) to show the facts behind the receipts, expenses, and inventories. Whether a satisfactory division of expenses and receipts can be made without a written record of the farm business operations is doubtful. A simple yet complete set of farm records provides a basis for a yearly settlement and supplies the information and evidence needed in filing income tax returns. A good set of records also serves as a guide for improving the efficiency of the farm operations. Sometimes another member of the family can help in keeping careful records (fig. 4).

All farm operating expenses and such fixed expenses as taxes, interest, and insurance, as well as all farm income from sales, custom work, or any other source, should be itemized in the farm records. The records should also include a detailed inventory of all farm property at the beginning of the agreement, and at settlement time it should reflect any changes in inventories of livestock, feed, equipment, and other personal property as well as improvements made in real estate. The amounts paid and received by each party should be clearly indicated and the ownership should be shown for all property—real estate, livestock, machinery, equipment, feeds and supplies, and any other property used in the business.

Any income or expense that is not to be shared should be noted. This will help to avoid misunderstanding at settlement time. A record of livestock production, crop yields, and farming practices is helpful in analyzing the business and serves as a basis for planning future operations. The farm accounts should be settled at least once a year and in some cases monthly settlements may be desirable. The yearly settlement is necessary when income tax returns are made out. The financial side of the business should be reviewed from time to time throughout the year to prevent situations that may lead to loss if they

Figure 4.—The son's wife takes over the keeping of the records with the close cooperation of her husband.

continue. If money is drawn regularly from the bank account to meet living expenses, it is important to know whether the business is paying its way. If not, adjustments can probably be made in the amounts taken out for personal use.

The final settlement should come at the same time each year. A decision should be made on the way in which any surplus is to be handled. Shall a certain part of it be left in the business for expansion or contingencies, or shall each party withdraw his share for his own use? Paying off the debt should be planned for. Also, enough of the profits should be left in the farm account to pay for operations during the coming year.

In addition to the cash accounting and settlement, inventories should be brought up to date. All property should be listed and the ownership interests of father and son clearly indicated. Numbers and kinds of livestock, types of equipment, and quantities of feed and supplies can be listed.

When the accounts are settled is a good time to take stock of the business. Whether the various enterprises and practices used on the farm have been profitable can then be decided. This stock taking may bring to light changes that can be made to improve the business. Farm records provide a valuable guide in this respect.

Several kinds of farm account books are available. Many State colleges of agriculture have excellent ones. Sometimes a county agricultural agent can get a set of books for a farm. Some Federal agencies, such as the Farmers' Home Administration, that deal with farmers directly, may have record books to give out. Whether one of these books or some other accounting system is used, depends upon the needs and the preferences of father and son. Either father or son may keep the records, although usually it is the son who does it, with the advice of the father. Perhaps they should check the accounts together at regular times to make sure that all items are recorded.

MANAGING FINANCES

Managing the finances needs special care when fathers and sons work together. During the early stages when the son is immature, the bank account may be in the father's name. But as the son's interest in the business increases, he should share the responsibility for handling finances. This gives him experience in handling money.

How the farm finances are to be managed should be definitely understood between father and son. Too many agreements drift along from projects to full-time joint operation with no definite plan for handling accounts. Father and son "just farm together." Operating and living expenses are paid from the father's account and any surplus goes back into the business. Although an agreement may be successful under these circumstances, the chances for harmonious, continuous operation are greater if there is a businesslike mutual understanding regarding finances.

A joint bank account in which all farm receipts are deposited and from which all expenses are paid is perhaps the easiest way. Either father or son, or both, may deposit money in the account and sign the checks. In addition to the joint account, each may want his own account for personal finances. If this plan is followed, each might draw a monthly or weekly allowance from the joint account and deposit it in his personal account.

Some fathers and sons handle their finances by maintaining separate bank accounts. They divide the main receipts and expenses as they go along and settle at regular intervals for minor items paid or received by each.

WRITTEN AGREEMENTS

Although many father-son agreements are oral, a written agreement has many advantages. Writing it helps to prevent misunderstandings that may arise when the father or the son forgets, or when their recol-

lection of an agreement differs. It puts the arrangement between them on a businesslike basis. Many oral agreements are indefinite, leaving decisions to be made from day to day as a question comes up. If the agreement is written and signed, the problems and terms will be more thoroughly discussed than if it were oral. This discussion helps the father and son to agree upon details and to have a clear understanding of the agreement. Agreements about shares in real estate must be in writing and signed, if they are to be legally enforceable. In many States, this may be true for any agreement that is to last for a definite period longer than a year.

A written agreement gives evidence of the son's part in the management and operation of the farm. Under it, he has a standing in the family relationship that is desirable from the standpoint of mutual cooperation and the development of self-reliance. A written agreement should be complete, yet fairly simple, with the provisions clearly stated. It should be reviewed and perhaps changed from time to time as new situations develop, such as changes in production and prices, the assuming of greater responsibility in management by the son, or an increase in his ownership of personal or real property.

Term of Agreement

Before entering into a father-son agreement, the probable length of time it is to run should be decided. The fact that father-son farming is a long-time proposition should be considered when details of the agreement are decided on. A flexible agreement that will allow for changes as the relation progresses is desirable. It is a good plan to review the agreement each year and to make the changes that are necessary to fit changing conditions. As is frequently done in leasing, father-son agreements may provide for automatic renewal from year to year. This provision is flexible, yet it provides for stability and the continuous operation that is likely to bring good results.

Termination of Agreement

Even though the agreement may be regarded as a long-time proposition, it is well to plan at the beginning how it can be ended. It may end unexpectedly because the son or the father dies. Or the ending may be because: (1) The son wants to move to another farm (to make room for a younger brother, or for some other reason), (2) the father wants to sell out to the son and retire, or (3) father and son may both prefer to end the arrangement.

Few fathers consider that their sons may die first. But as this sometimes happens the plans should be made with this possibility in mind. If the son should die, his wife and children (if any) need assurance that they will receive the son's part of the business, so the written agreement should show definitely the son's ownership interest in all property, both real and personal. How the interests of each are to be handled in case either dies should be a part of the agreement. If it is decided that the surviving party should continue to operate the farm, provision for this should be made. A lawyer should be consulted to insure that these provisions will hold legally.

If real property—land and buildings—is owned jointly, the agreement should state exactly how this property is to be divided when the agreement ends. It may turn out that this provision is what decides whether the farm can be kept together as a good operating unit. If the basic idea is to keep the farm going with no subdivision of

real property, the way the transfer is to be made should be agreed upon.

Perhaps special thought should be given to making a division of jointly owned personal property. Property to be used in farming by either father or son could be divided, each taking his share. Feed and supplies, certain kinds of livestock, and some machinery are easily divided. But division of expensive machinery and valuable breeding stock is not simple. Particular items may be needed as a basis for a new organization. Either father or son may need the tractor or the cows to continue farming. One of the following suggestions may be helpful in making a division: (1) Either father or son may sell his interest to the other at such price and upon such terms as may be mutually agreeable, (2) either may set a value on the entire property, or any part of it, and the other may buy or sell at this price, (3) the jointly owned property may be sold at a public sale, the expenses of the sale deducted, and the proceeds divided according to the respective interests of father and son, or (4) settlement may be by arbitration.

The partnership agreement may provide that upon the death of either party the survivor shall be entitled to buy his interest, or the father's will may provide that the son may buy out the other heirs. But it may be hard for the survivor to do this unless the will stipulates favorable terms, or unless he has or can get considerable money. Life insurance policies may be taken out to provide all or part of the purchase money. But it must be carefully decided who shall own, who shall be beneficiary, and who shall pay the premiums on each policy. In making these arrangements, it will be well to consult a lawyer.

LEGAL CONSIDERATIONS

Because of the legal implications, fathers and sons who are working out farm-operating agreements should consider such things as liabilities to third persons, rights in property, the taxes, and the probable consequences if either should die. Throughout their working relation, they will operate under some kind of legal arrangement, even though no thought has been given to that fact.

Information concerning the legal aspects of father-son agreements and tax problems is included here only for guidance. State laws vary and tax rates and procedures frequently change. So this information should be thought of as only suggesting the things to be considered in drawing up an agreement. A lawyer should be consulted when legal advice is needed.

Several legal relationships are possible, such as employer-employee, partnership, corporation, and landlord-tenant. Or, combinations of such relationships may be created. For example, the employer-employee relation may exist with respect to one enterprise on the farm and a partnership relation with respect to another.

EMPLOYER-EMPLOYEE RELATIONSHIP

The relation of father and son under a wage agreement is likely to be that of an employer and employee. As an employee, the son is not responsible for the liabilities and losses of the business. On the other hand, he has authority to do only the things that the father expressly or impliedly authorizes him to do.

The father is liable for the son's torts committed in the course of his employment (a tort is any wrongdoing in the eyes of the law, other than a crime or breach of contract). But the father may insure himself against most such liability (within the limits of the particular policy) by taking out farmers' comprehensive personal liability insurance.

PARTNERSHIP

By the time the agreement has advanced to the joint operation stage, father and son may want to form a partnership. This is easily done and, in many cases, it may best fit the needs and wishes of both. Partnerships make possible the equal sharing of profits and losses, and equal participation in management and operation. Contributions of property to the business can be made by each partner, and joint (undivided) ownership of property can be maintained. The partnership may acquire title to personal property and, in most States, to real property. But certain legal consequences of a partnership should be carefully considered.

By and large, each partner is the agent or representative of the other in carrying on the business in the usual way. This includes authority to go into debt, make contracts, and buy or sell partnership crops, livestock, and other property, in the usual course of the business, without the consent of the other partner. Not only partnership assets but also each partner's personal assets, including his separate property, may be held liable. A minor may disclaim personal liability at any time before or upon coming of age but, in most States, he cannot prevent partnership assets from being held liable.

The partners may agree to restrict the authority of each to incur obligations on behalf of the other. For example, they may agree that neither can make cash purchases or sales that involve more than a specified amount without mutual consent; or that neither can go into debt, enter into contracts, or make purchases on credit, without the other's written consent. But these restrictions protect the partners only against third persons who have been told about them. Therefore, it may be well that persons with whom the partners expect to do business be informed of the restrictions that have been agreed on.

Avoiding a joint checking account, or limiting its use, will not keep third persons from reaching partnership property and the personal assets of the partners to satisfy their claims against the partnership. But it will make more effective any limitations on authority that have been agreed upon, because it will preclude either partner from having unlimited access to a common fund. Then, too, people are likely to make inquiries before extending a large amount of credit or making a sizable loan to either partner. In such cases, they may ask the father to sign any note given by his son, or the son to sign any note given by his father.

Each partner (with the exception of minors in certain States) may be held liable to third persons for any torts committed in the course of the business by the other partner or by partnership employees. Farmers' comprehensive personal liability insurance may be used as protection against most of this liability. This type of insurance policy usually contains certain exceptions relating to the operation of motor vehicles, but automobile, truck, tractor, and implement liability

insurance can give protection to cover these exceptions. Although, under certain circumstances, each partner may be held liable for injuries to partnership employees, they may jointly take out employers' liability or workmen's compensation insurance against this risk.

In many States, a court may decide that personal property contributed to the partnership business has become partnership property, unless it has been otherwise agreed. Therefore, a partner who wants to retain exclusive ownership of the personal property he contributes would do well to see that there is a written and signed agreement to the effect that he is contributing only the "use" of such property. This may be especially important if one partner should die while the partnership is in force.

If one partner dies and the partnership agreement does not provide otherwise the surviving partner may have to settle the business immediately and may be called upon for an accounting. Property held in partnership may have to be sold and the proceeds distributed in cash if so demanded by the surviving partner or the deceased partner's legal representative. Hence it may be well to include in the agreement provisions concerning settlement. Suggested provisions that may be included are listed under "Termination of agreement," page 30.

CORPORATION

Although farm corporations are permitted in most States, they are not usual. Corporate farming is more complicated and expensive than any of the other methods considered here.

Organizing and carrying on a corporation involves considerable "paper work." Articles of incorporation and by-laws, if these are desired, must be drawn up. The corporation must be chartered by the State, and must remain under its supervision. An annual financial report must be made and any transfer of stock, changes in officials, and other activities may have to be reported. An annual stockholders' meeting must generally be held and usually there must be at least three incorporators and three directors (although an incorporator may also be a director).

The liability of members of a corporation, called stockholders, for corporate obligations is usually limited to their capital investment plus their share of undistributed profits. But in the case of a father and son engaged in farming, the capital invested by each, and especially by the son, may represent his total assets.

Stock certificates are evidence of ownership in a corporation. They provide a clear record of each stockholder's proportionate rights in corporate assets and profits and, therefore, a clear-cut method by which the son may gradually buy into the corporate business. But they are of no help in distinguishing corporate property from the separate property of father and son.

Death of a stockholder or other changes in membership need not affect the life of the corporation. It may continue indefinitely. On the other hand, dissolving it may be both bothersome and expensive.

LANDLORD-TENANT RELATIONSHIP

Another possible legal relation is that of landlord and tenant. Under this relation the operator or tenant usually provides all or

most of the labor and management for operating the farm. Ordinarily, the tenant supplies all or part of the operating capital and equipment as well. If the son is the operator he is the tenant and his father is the landlord.

Generally neither landlord nor tenant may bind the other, without consent, by incurring debts, entering into contracts, or selling farm products or other property in which both have an interest. Nor is either party usually liable for any torts committed by the other under the landlord-tenant relationship. But if either authorizes the other to do certain things on his behalf, he may be held liable for obligations incurred or torts committed by the other while acting under the authorization. As is true for partnerships, most tort liability may be covered by insurance.

In some livestock-share leases, especially when the landlord (father) has a part in the day-to-day management decisions, owns a share of the livestock and operating equipment, and contributes his labor to the business, the relation closely resembles a partnership. Under this arrangement, it is hard to say whether the courts in deciding a particular question would regard the agreement as a partnership, a lease, or both.

DECIDING WHICH LEGAL RELATIONSHIP TO USE

Choosing the type of legal relationship to follow in operating a farm depends on the particular circumstances under which the agreement is formed. For example, most fathers and sons would not be working together if they did not have mutual trust and respect. Therefore, they may not be concerned about partnership liabilities to third persons. Or they may feel that the many advantages of a partnership outweigh the liabilities, as many of the risks can be covered by insurance. The landlord-tenant relationship is best suited to the father who wants to retire and turn over the operation and management of the farm to a tenant. It is not so well adapted to joint operation.

Aside from the corporate possibility, if father and son jointly participate in the operation of the farm business on an equal managerial basis, and share in its profits, it may be hard to create anything but a partnership. Avoiding a partnership will be even more difficult if both have invested capital in the business, or if they have a joint bank account, or if much of the property used in the business is owned jointly rather than separately. These are all earmarks of a partnership. In order to prevent the formation of a partnership, father and son would probably have to give up some of these features, such as a joint bank account, even though they may think them desirable.

Even by taking such steps, they cannot be sure that a partnership will not be formed. Because of differences in court decisions, it may be easier to avoid a partnership in one State than in another. Chances of preventing its formation may be improved by including in the written agreement an express disclaimer of a partnership, together with a denial of any authority of one to act for the other. Ordinarily, this will not guarantee that a partnership can be avoided, so it may be well to guard particularly against partnership liabilities, even

though what is considered a nonpartnership arrangement has been drawn up.

TAX CONSIDERATIONS

Income, property, gift, estate, and inheritance taxes may all have some significance in father-son operations. From the standpoint of day-by-day operations, the Federal income tax is probably the most important.

Even though the son is a minor, he must file a Federal income-tax return if his gross income is more than a specified amount ($600 in 1949). But the father cannot claim him as an exemption if the son has a gross income of $500 or more or if the father did not furnish more than half of his support (as applied to 1949 income).

A partnership must file a return of income that is separate from the returns of its members, but it is simply an information return. No tax is paid by a partnership. Instead, each partner's share of partnership income (whether or not it is distributed to him) must be reported in his individual tax return. Landlords and tenants do not file joint returns. Each reports his share of the income of the farm business in his individual return. There are some differences with respect to income taxes between a partnership and a landlord-tenant form of farm business. But these differences appear to have little bearing on the advisability of creating one type of agreement in preference to the other.

Interest on capital invested or wages paid by a partnership to either partner cannot be deducted as a business expense on the partnership return. For income-tax purposes, wage payments must be treated as withdrawals against profits and interest payments as an adjustment in the division of profits.

If one partner, instead of selling property to the partnership, simply transfers it to the partnership and receives credit for it as a capital contribution, he need not report a gain or loss on the transaction. The basis for figuring depreciation, and gain or loss, if the property is later sold, is the same as though the partner who contributed it had retained ownership. The partnership must report the whole gain or loss on such property from the time it was originally acquired by the contributing partner.

There may be a difference in total Federal income taxes paid by father and son if they incorporate. A corporation must pay a tax on any taxable income it reports, and must file a return even though no taxable income is reported. A corporation may deduct wages, rent, or interest paid to father and son, or anyone else. These payments may so reduce the corporate net income that little or no tax need be paid. But if the corporation must pay a tax, this tax combined with the income tax of father and son, may be higher than if they had not incorporated. For those few who would otherwise have had a combined net income above $20,000 (no hard-and-fast line can be drawn), incorporation could often result in a saving in taxes under the rates that applied to 1949 income.

It is not easy to say to what extent corporate taxable income may be reduced through the payment of wages, rent, and interest. Salaries reported must be "reasonable" in amount and wide fluctuations from year to year may be questioned, especially if no regular monthly payments have been made.

If dividends (representing profits) are distributed, incorporation will be made less desirable, as far as the income tax is concerned, as double taxation would result. That is, the corporation would pay a tax on the profits these dividends represent and the stockholders would pay a tax on the dividends received. But as long as it can be shown that profits are left in the corporation for expanding the business no dividends need be distributed.

Most States have one or more taxes which apply particularly to corporations. There is a Federal tax on stock transfers, and often a State tax as well. When there is a State income tax, the rates may differ for individuals and corporations.

Whenever the father makes an outright gift to the son (or partnership or corporation), or transfers property at substantially less than its value, he may be subject to gift taxes. However, he is entitled to certain exemptions each year. In addition, he is entitled to a sizable basic exemption, which he may spread out over several years as he sees fit. Gifts made by either husband or wife may be treated as having been made one-half by each, thus increasing the exemptions for gifts made in fact by only one. If husband and wife consent to this arrangement it must apply to all gifts made by either of them during the year.

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